Chapter- 6  Summery of Conclusions, Findings and Recommendations

6.1 Summary of Conclusions
6.2 Findings
6.3 Recommendations
6.1 Summery of Conclusions

A number of developments have taken place in the Indian capital market with the launching of financial reforms since July 1991. With the advent of liberalization, the India capital market has gone under tremendous changes. Prior to liberalization, the India stock market was not in the global picture. But today, it is one of the most attractive markets for the Foreign Institutional Investors (FIIs). The establishment of SEBI as an apex institution for the capital market was the most important decision to proceed towards the globalization. It was SEBI, who in consultation with the Ministry of Finance and Government of India took number of steps to bring the Indian capital at par with the global standards. Some of these steps were establishment of OTC, NSE, NSDL, CDSL, ICSEI and introduction of number of innovative financial instruments, which were prevailing in the global markets. To achieve the globalization should not be the only objective, but Government of India in consultation with the SEBI must take certain measures to provide the maximum benefits to the Indian Investors from the India capital market rather than to FIIs.

India's economic growth has been robust with an average GDP growth rate of over 5.5% p.a. for the last 20 years. However, despite several policy reforms the Indian stock market has gone nowhere since March, 1992. It is noteworthy that this excellent growth record has been achieved in the presence of very high and rising, real interest rates. The effect of economic
reforms on the stock market has been nullified by these increasing, and high, real interest rates. Hence, the Indian stock market has gone nowhere since March, 1992. Given that growth has been accompanied by wide ranging reforms covering external, fiscal and financial sector, it would be logical to assume that the financial markets performance would have fully discounted the reform story in India by way of higher valuations.

Taking into account international experience and needs of the financial markets, NSE launched NCFM (NSE's Certification in Financial Markets). It tests practical knowledge and skills that are required to operate in financial markets, in a very secure and unbiased manner, and certifies personnel with a view to improve quality of intermediation. With the Internet becoming ubiquitous, many institutions have set up securities trading agencies that provide online trading facilities to their clients from their homes. This has been possible since all the players in the securities market, viz., stockbrokers, stock exchanges, clearing corporations, depositories, DPs, clearing banks, etc., are linked electronically.

Indian Capital Markets have grown exponentially in the last few years. The growth has been in every sphere, in the amount of capital raised through primary issuances, in exchange trading turnovers, in the market indices and market capitalization, in mutual fund assets and foreign institutional investment. Corporate earnings are growing at healthy pace and the markets are a reflection of the health of the Indian economy. The Indian capital market attained further depth and width in business transacted during 2007. The Bombay Stock Exchange (BSE) Sensex, which had been witnessing an
upswing since the latter part of 2003, scaled a high of 20,000 marks at the close of calendar year 2007 and 21000 in January 2008. The National Stock Exchange (NSE) Index rose in tandem to close above the 6,100 mark at the end of 2007. Both the indices more than tripled between 2003 and 2007, giving handsome yearly returns. Alongside the growth of business in the Indian capital market, the regulatory and oversight norms have improved over the years, ensuring a sound and stable market.

In the process capital market is being rebuilt some of the important developments that have taken place in the Indian market. The path ahead is as challenging as was the path we had traversed all these days. But with the experience and learning of all these years we are confident of surging forward successfully setting new standards in the process. In post liberalized era we achieved a lot in regard to growth in the number of transactions, turnover on daily, monthly and yearly, market capitalization, FIIs and mutual fund investment, number of players, number of instruments, profitability, liquidity, marketability etc. Growth in these factors is definitely a signal of strength of the capital market, but this is also a reality that the Indian market has become volatile in post liberalized era. This volatility is adversely affecting the interest of the real investors. This is the duty of the Government of India along with the SEBI to capitalize the impact of globalization and liberalization but simultaneously the continence level of the investors in the market should also be taken care of. This can be achieved by taking necessary measures to curb speculative trading and giving more emphasis on the protective measures in the Indian capital market then only real benefits of liberalization we can taste.
otherwise FIs will reap maximum benefits from our market and our small investors will suffer.

6.2 Findings

After going through the research on the topic "Impact of Liberalization on Indian Capital Market", the following facts came into knowledge:

1. The volatility has increased in the Indian capital market after the post liberalization period. This volatility is greater as far as the daily prices are concerned and it has lesser in case of volatility calculated on the basis of month end prices of stock. Further it is again comparatively less if consider on the basis of yearly prices of stocks. Thus, the investors will always be at greater risk when they are busy in intraday or jobbing. On the other hand, if they invest and hold it for the substantial period of time then they will be in better position as chances of returns are greater at minimum risk of volatility. In other words, it can be said that the more time investors hold the fund the better return and lesser risk they will be exposed to.

2. Prior to liberalization, the Indian capital market was not much volatile as it was not exposed to the global environmental factors. But after the economic liberalization and FIs investment in the Indian capital market, slowly and gradually the market has become more volatile. The financial year 2007-08 has experienced most volatile year. Hedge funds and FIs could have been the biggest sellers in the Indian markets, booking profits and making the most of the unprecedented
Bull Run that has dominated the Indian stock market for a long time now. The current volatility is also linked to global bourses. There is a big correlation among global markets. The presence of hedge funds across asset classes, along with increased global movement of capital, has increased event-related volatility. Volatility in commodities markets has also significantly affected equity markets. A combination of global and local factors is affecting this market. On the local front there has been a huge build-up in derivatives positions and volatility led to margin calls. Also many IPOs have sucked out liquidity from the primary market into the secondary market.

3. After going through the research, discussions and consultation with different investors and brokers; I came to know that investor who invests at right time and hold the securities for substantial period of time is likely to get more return on investment. Those as a matter of greed do intra day or jobbing or trying to get speculative profit in very short time are likely to suffer from losses and mental tension.

4. The liquidity and marketability in the Indian capital market has improved after liberalization of the financial sector and establishment of NSE and depository institutions like NSDL and CDSL. These institutions have really contributed a lot in improving the efficiency of the market. The transaction cost in the form of brokerage has reduced sharply with the operation of depositories. As a result of this, the number of players, turnover and market capitalization in terms of % of GDP etc. have achieved handsome growth in post liberalized era.
Market liquidity increased greatly between 1992 and 2007. This was a function of changes in settlement rules and the introduction of derivatives trading. The NSE introduced trading in equity derivative products in June 2000. It has since become the largest exchange in single stock futures and it ranks fourth globally in the number of stock index futures contracts traded.

5. The Indian capital market was untapped, unexplored and under valued prior to liberalization. In liberalized regime, the market got tremendous exposure at global level. FIIs, Mutual fund companies and other investors started getting the untapped profit from the market. As a result, the Indian market started giving more return to the investors. The financial year 2006-07 proved that the Indian capital market the most profitable in terms of P/E ratio in the world.

6. The commodity and derivative market is also affecting the performance of the equity capital market. If there is selling of securities in the capital market, if parked in the derivative segment. It is expected the markets to continue to be choppy for a while till global liquidity and commodity prices settle in. With the markets falling, a technical correction in the derivatives segment has perpetrated a larger fall.

7. Equity markets have evolved considerably since the early 1990s and amongst the largest in the world in terms of transactions and have costs comparable with the major exchanges. Cost was also reduced by the starting of the new clearing and settlement institution. An integral part of the new architecture was the creation of centralized
counterparty for transaction. At the same time depositories reduced settlement risk. Before the establishment of NSE the cost of transaction used to be 3.75% which has declined to 0.65% in 1997 and further 0.35% in 2004. Similarly the settlement cost of back office and bad paper risk has also declined sharply and as result the turnover has increased tremendously.

8. The stock indexes rose sharply from 2005 to 2007. During the year 2005 the Sensex touched 6000 points which grew to 21000 point on January 1, 2008. Since stock indexes are barometer of the economy and economy could not grow at more than 10% in a year during this period but the indexes grew almost 300%. It cannot be digested; it was only due to the speculative trading by most of the players in the market. Investors should be careful in regard to investment If any where market grow in this fashion. The market I likely to crash to get normal position as it happened in India after touching the Sensex as high as 21000 points, crashed to restore normal condition of around 13000 to 15000 points.

9. There is no need to get very pessimistic that this is the end of equity investing in India. This could be seen as a buying opportunity and we will re-visit market valuations after the correction. India cannot escape a global meltdown. With fears of an impending US recession high, no country is likely to be spared.

10. FIIs have slowly and gradually started making grip over the affairs of Indian capital market. When the market is under valued they will show
interest in the market and if it is over valued they will do profit taking. This will be the usual practice of FII's in the market. They keep on shuffling their fund from one market to another to get best result. Whenever they buy, most probably the market indexes are in green color and if they sell then the indexes are in red. It shows they are really dictating the market.

11. The maximum benefit of the market is taken by FII's and followed by the mutual fund companies. The retail investors are the least beneficiaries in the market. Retail investors cannot affect the market as compare to FII's and Mutual fund companies because their investment carrying small amount of transactions.

12. The turnover of the spot and derivatives market of NSE and BSE continued to show an upward trend. During 2007, NSE and BSE spot market turnover showed a rise of over 60 per cent and 47 per cent, respectively, over the previous year.

13. The Indian capital market has created the global impact in international scenario. There was a time when Indian capital market was nowhere in the global picture prior to the liberation. But today, Indian market is considered to be the most emerging market of the world along with Taiwan, Korea, China, Malaysia and Indonesia. The global impression has improved only after the establishment of NSE, the stock national exchange with latest and sophisticated technology and depositories which have facilitated the investors by providing the trading and custody of securities in Demat form. It has also facilitated in bringing
the cost of transaction to lower side and improving the over all efficiency of the market.

14. The market has got the exposure of international business environment. Now it will affect the market if here is a change in the global investment climate or any other issue like oil prices, US economy, War etc. One of the primary triggers is the huge fear of the United States' economy going into a recession with foreign institutional investors trying to reallocate their funds from risky emerging markets to stable developed markets. Analysts are now expecting a cut in US interest rates.

15. Sound macroeconomic environments and sufficiently high income levels: Income levels, domestic savings, and investment are important determinants of stock market development in emerging markets.

16. Transparent and accountable institutions. Law and order, democratic accountability, and limited corruption reduce political risk and enhance the viability of external finance. They are thus important determinants of stock market development.

6.3 Recommendations

Over the last few years, there have been substantial reforms in the Indian capital market. But there are still many issues to be addressed to make it more efficient in mobilizing and allocating capital. Inflow and outflow of capital would continue to pose serious problems; high degree of volatility in the equity market. The following points are suggested:
1. The concerned authorities must pay attention to the market in regard to protect the interest of the small investors from the global threats. In this direction, the number of players should be encouraged like recently permission has been given to insurance companies, provident fund, pension fund, post offices etc. so that if there is crash in the market due to the withdrawal of funds by FIIIs; it must be filled by these players to protect the interest of the small investors. The efficacy of the investor protection systems as well as the reforms be keep on going by the authorities.

2. Proper economic policies should be formulated and implemented as well to give boost to the companies. It will give better result to the performance of the corporations and capital market.

3. Small investors should be careful in parking fund in the market if the market in over priced. They should always keep in mind that if the economy grows at the rate of around 8% to 9%, how one can expect a return of more than 50%.

4. Indian capital market lacks professionalism. NSE initiated NCFM (NSE’s Certification in Financial Market) in this direction to provide certification in different specialized areas of capital market. BSE, too initiated BCFM (BSE’s Certification in Financial Market) to bring professionalism in the market. But it should be accelerated.

5. Presently the settlement system of T+2 should be brought down to T+1 to improve the liquidity and marketability of securities in the
market. It will also make the market strong by increasing the number of players.

6. The OTC market should also be promoted to encourage small and medium sized companies. There is an urgent need to increase the number of trading terminals in other cities to provide the platform to companies.

7. Government of India and SEBI should give more attention to bring the operational efficiency at par with developed economies. Apart from this, a strong campaign should also be initiated to counsel the investors of grass root level. The concentration of investors is from urban area.

8. The volatility caused by speculators is shaking the confidence of the investors in the market. Regular speculators should be watched, identified and monitored. They should be discouraged from the speculative activities. It will lead to build the confidence of the investors.

9. Relevant information must be made available to the user in a friendly manner and at a low cost. Regulations must require disclosure of material particulars as well as risks relating to products and services.

10. The Indian capital market (primary and secondary) has grown over time but compared to other emerging and developed economies, the investor base in India, although increasing, is still very small and the turnover ratio is the lowest and has a declining trend. Therefore, the
investor base should be increased by projecting the stock markets as centers of higher returns on investments and not merely as casinos. Equity culture among the masses should be developed. This requires that investors' interest should be protected by the regulatory authorities. Again, the turnover is small and declining because only a small number of scrips are traded on a regular basis in the stock markets.

11. A plethora of channels through which financial advice is given and received only adds to confusion and insecurity make regulations for investment advisors.

12. According to market analysts, about 30% of American funds come to India through Mauritius and the remaining portion invests directly into Indian equities. Active FII account to only about 11% of the total FII registrations. "Though this ruling only has 'persuasive value', it will only add up tax uncertainties for foreign investors investing in India. FII have always been uneasy about taxation procedures in India."

13. Indian tax laws are very unclear. FII pay taxes on capital gains in any other emerging markets other than India. There is always tension among investors whenever there are revisions or changes in policy matters.

14. It doesn't mean the Indian capital markets everything is hunky dory and needs no improvement, polishing or refurbishing. In fact, dynamics of the global environment dictates that those charged with the responsibility of bringing about changes must always seek out
new learning by experience, criticism and judgments. The market depth needs to be supplemented with further product diversification—mortgage and asset backed securities, warrants, and disinvestment in the public sector. The debt market of India, though large and next only to Japan, in Asia lacks vibrancy and does not provide adequate options for meeting medium to long term funds, required for green field projects, in particular. Infrastructure funding (essential for continued high economic growth) has become an issue in the absence of a vibrant debt market. There is no market for below investment - grade paper or what is called junk bonds.

15. We should make the corporate debt market vibrant including cash and future, operationalization of Indian Deposit Receipts (IDRs), and corporatisation and demutualization of remaining stock exchanges (has already begun with Stock Exchange Mumbai) where the ownership, management and trading rights resides with three different sets of people in order to avoid conflict of interest.

16. The penetration level of the investors in the market is still very low. New products are to be introduced to meet the needs of all kinds of market participants. MAPIN (unique identification) has to be extended to cover entirety of market participants.

17. National training and skill delivery institute has to be commissioned quickly to build a cadre of professionals to man the specialized functions in the capital market. There is a need to spread equity cult
and build institutions like pension funds to enlarge the size of the market and balance volatility.

18. The regulation of listed companies, a job performed in a fragmented manner by SEBI and Ministry of Company Affairs, needs to be consolidated to eliminate regulatory arbitrage, shooting out from the kinks of regulatory jointing by unscrupulous operators, and blurring of regulatory accountability. Further, regulation is an evolutionary process and has to be refined on an ongoing basis.

19. Thus, SEBI would and should continue to travel on the learning curve with a view to reorient and reconfigure ground rules (regulations), its investigating abilities and investor protection measures.

20. The impact cost which is 0.08% in India, which can further be dropped to make the liquidity better than what we are having today.

21. From safety and protection point of view, the Indian capital market needs lot to do. The developing countries like Mexico, Thailand, South Africa and Malaysia are having better position in terms of safety and protection index. To bring the continence level of investors high, the concerned authorities have lot to do in this regard.

22. Improving liquidity in government securities would require the diversification of investor base to the non-traditional investor groups like individuals, firms, trusts and corporate entities. Also there is an immediate need for the development of a rupee yield curve for a greater integration between the domestic foreign exchange and debt.
markets. The yield curve shows the direction and intensity of future interest movements.

23. The interest of the people and liquidity gets diminished. Such scrips and companies need to be activated. The volatility, in terms of spread and co-efficient of variation of security returns, has started rising again since 1996-97. Consequently, the ordinary or individual investors have suffered heavy losses and lost interest in the stock markets. The stock market activity is increasingly becoming more centralized, concentrated and non-competitive, serving the interest of big players only. The foreign institutional investors have been playing an important role in this aspect. Their role should be reduced. This seems possible only by increasing the domestic investors’ base (individual and corporates) and encouraging mutual funds and counteracting the profit-taking activities of FIIs. But, even after the SEBI had provided operational freedom for mutual funds, the investor is not showing enough interest in mutual funds.

24. The stock market efficiency has not improved significantly after the initiation of reforms. Although, lot of reforms has been introduced in the capital market, most of them are concerned with the big institutional investors. For an ordinary investor, the earlier issues like insider trading, price rigging, manipulation /exploitation by brokers and sub-brokers, and speculation, etc. still exists. Other issues like price bands, clearing and settlement, and depository infrastructure
need to be addressed for the proper implementation of rolling settlement system.

25. Development of an active debt market is vital for financial market efficiency. The debt market in India is conventionally classified into three segments, namely, government securities market, public sector units (PSUs) bonds market and corporate debt market. At present, India's debt market is one of the largest in Asia next to the Japanese and the Korean. Central to the development of the debt market in India is the development of the government securities market. Although private placements of corporate debt and the wholesale debt segment of the NSE have increased substantially, the daily trading volume in this segment is small compared to its size. The ratio of daily trading volume to total debt outstanding is less than one percent in India compared to 6.5 percent in USA. Hence, there is a problem of illiquidity in this segment. There is a high volume of Government stock which yields a coupon of seven to eight percent which is not being traded at all.

26. Investor confidence in stock investment is low. This must be regained in order to encourage capital mobilization through primary market issues. Further strengthening of investor protection, and improvements in transparency, corporate governance, and monitoring will be necessary. The capital market infrastructure, such as accounting standards and legal mechanisms, should also be improved to this end.
27. Several policy measures have been taken to activate the debt market, such as competitive pricing of Government securities, initiation of open market operation including repo operation, and a larger percentage of mark-to-market valuation. These measures have had a beneficial impact on the system, such as greater market absorption of Government securities, lower absorption by RBI, and increased attention by investors to interest rate risk management. However, further measures have to be implemented to encourage the development of the debt market, including reduction of the 23 percent statutory liquidity requirement ratio and 100 percent mark-to-market valuation for all banks.

28. In order to increase liquidity of Government securities, diversification of the investor base with nontraditional investor groups such as individuals, firms, trusts, and corporate entities is necessary. Diversification is also important to promote an active market in which investors' buying and selling needs vary across time. Banks, financial institutions, and provident funds are the predominant holders of Government securities. To promote diversification of investors, mutual funds could be encouraged to establish gilt funds to invest in Government securities through tax incentives, and for primary dealers to diversify the investor base. Fully market-based interest rates for issuing Government securities are also necessary. The credibility of credit-rating companies should be further established.
29. **Risk Management:** The rules that have been introduced during the last few years to contain market risks seem to have operated reasonably well. Strict enforcement of these rules is as important as the rules themselves to effectively manage risk. In this regard, SEBI should more closely inspect intermediaries and the stock exchanges and, if necessary, strengthen punitive measures.

30. **Integration of the Capital Market with the Banking Sector:** Capital markets cannot thrive alone—they have to be integrated with the other segments of the financial system. Effective and efficient capital markets require a stable and strong payment, settlement, and clearing systems. India's banking system is yet to come up with good EFT solutions. EFT is important for solving problems such as those related to direct payment of dividends to bank accounts, eliminating counterparty risk, and facilitating FII investments.

### Matrix of Policy Recommendations

<table>
<thead>
<tr>
<th>Issues</th>
<th>Policy Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. Market infrastructure</strong></td>
<td></td>
</tr>
<tr>
<td>1. Accounting principles</td>
<td>• Improve accounting principles; make them consistent with international practice.</td>
</tr>
<tr>
<td></td>
<td>• Strictly enforce punitive measures for inaccurate accounting practice.</td>
</tr>
<tr>
<td>2. Legal mechanism</td>
<td>• Establish prompt and effective settlement of disputes to protect small investors' interests.</td>
</tr>
<tr>
<td><strong>B. Corporate governance</strong></td>
<td>• Grant institutional investors voting</td>
</tr>
</tbody>
</table>
### Chapter-6

**Summery of Conclusions, Findings and Recommendations**

<table>
<thead>
<tr>
<th>C. Cost of capital issue</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Streamline the procedure for public subscription of securities to reduce transaction costs in terms of time lag and uncertainty.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>D. Debt market</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Diversification of investors</td>
<td></td>
</tr>
<tr>
<td>• Apply fully market-based interest rates for issuing Government securities.</td>
<td></td>
</tr>
<tr>
<td>• Further reduce statutory liquidity requirements.</td>
<td></td>
</tr>
<tr>
<td>• Further enhance the credibility of credit rating agencies.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>2. Stamp duty</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Amend stamp duty regime by the Government of Maharashtra, where Mumbai is located, in the form of one time levy or consolidated fee payable by National Securities Depository, Ltd (NSDL).</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>3. Private placement</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Indicate the framework within which the private placement has to function to protect investors from risk associated with subscriptions in the private placement market.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>E. Integration of stock exchanges and consolidation of intermediaries</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Provide favorable environment or some incentives for establishing central trading system through interconnectivity.</td>
<td></td>
</tr>
<tr>
<td>• Encourage the corporatization and</td>
<td></td>
</tr>
</tbody>
</table>
### F. Risk management
- Securities and Exchange Board of India to more closely monitor and inspect the intermediaries and stock exchanges and, if necessary, strengthen punitive measures.

### G. Integration of the capital market with the banking sector
- Banking system to establish a good electronic funds transfer (EFT) solution to enable direct payments of dividends to bank accounts, eliminate counterparty risk, and facilitate FIIIs.
- Encourage sound competition between the banking sector and the capital market through more banking liberalization.